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No. 89-2001 and No. 90-131

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

PANHANDLE EASTERN PIPE LINE COMPANY, *et al.*,
Petitioners,

v.

COLUMBIA GAS TRANSMISSION CORPORATION, *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

COLUMBIA GAS TRANSMISSION CORPORATION, *et al.*,
Respondents.

On Petitions for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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PIPELINE PETITIONERS' REPLY TO RESPONDENTS' BRIEFS IN OPPOSITION

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INTRODUCTION

The pipeline petitioners[1] hereby reply to the briefs in opposition filed by the Municipal Defense Group ("MDG") on July 25 and August 31, 1990, and by Columbia Gas Transmission Corporation, *et al.* ("Columbia") and Process Gas Consumers Group, *et al.* ("PGC") on August 31, 1990.

SUMMARY OF ARGUMENT

1. Respondents' briefs in opposition succeed only in showing that this case does indeed present a question worthy of this Court's review. First, respondents claim that the Court's decision late last term in *Maislin Industries, U.S., Inc.* v. *Primary Steel, Inc.*, No. 89-624 (June 21, 1990), forecloses the Commission from granting a waiver under Section 4(d) of the Natural Gas Act to permit a surcharge for gas sold in a past period, as it did here. But that is the precise question the Court expressly left open in *Arkansas Louisiana Gas Co.* v. *Hall* ("*Arkla* v. *Hall*"), 453 U.S. 571, 578 n.8 (1981). Whether *Maislin* intended to decide, *sub silentio*, the issue preserved for future consideration in footnote eight of the Court's opinion in *Arkla* v. *Hall* (as respondents claim) is itself surely a question worthy of this Court's plenary review. Second, respondents' own arguments demonstrate that the equitable allocation of large, past-period gas costs among pipeline customers is a serious and recurring problem in pipeline rate proceedings before the Federal Energy Regulatory Commission ("Commission"). The pervasiveness of this problem further reinforces the need for this Court to resolve the question of the Commission's statutory authority. Finally, by their own submissions, respondents would com-

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[1] The list of all parent companies and subsidiaries of the petitioners, as required by Rule 29.1 of the Court's Rules, was provided on p. iii of the petition for certiorari in No. 89-2001.

pletely upset the time-honored symmetry of the statute by making utilities responsible for refunding past-period *overcharges* to all customers while allowing select groups of customers to escape their fair share of responsibility for past-period *undercharges.* This perversion of the statutory purposes likewise warrants this Court's review.

2. Respondents' briefs in opposition contain several material inaccuracies of fact. We correct those herein.

3. Finally, respondents plainly are wrong in urging that the Court deny certiorari in this case regardless of any action it may take in *Associated Gas Distributors* v. *FERC*, 893 F.2d 349 (D.C. Cir. 1989), *reh'g denied*, 898 F.2d 809 (D.C. Cir. 1990), *petitions for cert. pending*, Nos. 89-1988, *et al.* ("*AGD-II*").

ARGUMENT

1. a. Both Columbia (Br. 21) and MDG (Br. 2 n.2, 8 n.7, 9, 22-23) argue that this case is controlled by the Court's recent decision in *Maislin Industries, supra.* We submit that this claim cannot withstand analysis, and that, in any event, respondents' own arguments demonstrate that this case presents an issue worthy of certiorari.

Reduced to its essentials, *Maislin*, like *Arkla* v. *Hall* and this Court's other "filed rate doctrine" cases, holds only that the terms of a private agreement for a regulated service, such as rail transportation, cannot, as a matter of law, supersede the filed rate. In *Maislin*, the Court held that this rule applied even when the regulatory body (in that case the Interstate Commerce Commission ("ICC")) declared in response to a referral from a federal trial court that the filed rate should *not* prevail. As the Court explained, the filed rate continued to have the force of law unless found to be "unreasonable" by the ICC, which did not occur. *Maislin*, slip op. 11-12 and n.10.

In contrast, this case concerns the *Commission's* authority, under the waiver provisions of Section 4(d) of

the Natural Gas Act, to approve a *change* in the filed rate, upon a proper filing by the regulated utility, permitting the utility to impose a surcharge for past undercollections that resulted from a Commission mandate to defer cost recovery. That is a question never before decided by this Court, and, indeed, expressly left open by Justice Marshall's opinion for the Court in *Arkla* v. *Hall*, 453 U.S. at 578 n.8. Columbia (Br. 18 and n.22) suggests that the cases appearing to recognize such a waiver power on the part of the Commission under Section 4(d) may have been implicitly overruled by *Maislin*. We disagree; but, in any event, respondents' submission by its own terms shows that this case raises a question worthy of certiorari.

There is absolutely no merit to the suggestion (Columbia Br. 3, 17-18; MDG Br. (No. 90-131) at 3) that this case is distinguishable from the situation envisioned by footnote eight in *Arkla* v. *Hall*, because of a purported lack of contractual agreement between the petitioner pipelines and their wholesale customers for payment by the customers of the costs at issue here. It is beyond dispute that the underlying service agreements between the pipelines and their customers, like the producer-pipeline contracts under which these costs originally were incurred, provide simply that the customer will pay the FERC-approved rate for gas, subject only to the customer's right to protest and seek a hearing concerning rate changes.

b. Columbia's theory of the case is that the "purchased gas adjustment" ("PGA") provisions found in many pipeline tariffs provide an effective and lawful method for recovering large amounts of deferred costs from past periods. *E.g.*, Columbia Br. 5 and n.7, Br. 10 and n.15, Br. 19. Thus, Columbia (Br. 10 n.15) notes that the Commission in one instance authorized one of the pipeline petitioners to collect some $170 million in unrecovered gas costs accured during a prior period by amortizing the total amount and collecting it in installments through its PGA account.

Again, Columbia's submission only reinforces our contention that this case does indeed warrant this Court's review. First, the instances cited by Columbia (and many others could be cited), in which gas purchase costs from past periods are passed through to pipeline customers in the current period, demonstrate that the problem presented here—*i.e.*, the deferred recovery of production-related costs under Section 110 of the Natural Gas Policy Act, 15 U.S.C. § 3320—is not an isolated or unusual situation, but rather a recurring problem, particularly during the massive restructuring now underway in the industry. The Commission's statutory authority to handle these situations in an equitable and lawful manner thus presents a question of very substantial practical importance.

Second, respondents, in attempting to discredit the direct billing methodology employed by the Commission in this case, prove too much. If the Commission is without power to impose the surcharge it attempted to impose in this case, as Columbia claims, then it is difficult to believe that the same costs would not be challenged if petitioners had employed a surcharge under the PGA mechanism. Indeed respondent MDG expressly challenges the use of the PGA for this purpose (MDG Reply Br. in *Columbia II* (filed August 22, 1989) at 5). Columbia (Br. 5 n.7) acknowledges that "the PGA mechanism for 'truing up' recovery of past gas costs is a departure from the normal process of setting fixed rates for the future based on estimates derived from historical experience," but suggests that the distinction lies in the fact that "the PGA mechanism itself is on file as part of the pipeline's tariffs." But that is no distinction at all, because the petitioner pipelines likewise proposed their direct billing plans by means of Section 4 rate filings; the Commission designated the charge as a "rate" and permitted it to become effective. *E.g.*, Pet. App. (No. 89-2001) 72a.

c. Respondents also claim that the direct billing mechanism approved by the Commission in this case promotes an "asymmetrical outcome" (Columbia Br. 17) by per-

mitting retroactive rate increases which undermine the "consumer protection" purposes of the Natural Gas Act (Columbia Br. 16-17; MDG Br. (No. 89-2001) 26-27; MDG Br. (No. 90-131) 12, 14, 16; PGC Br. 4-5). In truth, however, it is respondents' position that results in a perversion of the statutory purposes.

Under the respondents' view of the law (as adopted by the court of appeals in this case), if a pipeline *overcollects* its costs in one period, it has an absolute obligation to refund those amounts at the earliest possible moment, to assure that the refunds reach those consumers whose payments proved to be too high. Yet, if during the same period the pipeline *undercollects* its gas costs—either because of a flawed projection (as often happens in PGA proceedings) or (as here) because the Commission had not yet permitted the pipelines to include certain costs in their then-current charges—the respondents would allow the customer to avoid meeting its cost responsibility by simply cutting back on its current purchases, which would shift the same costs to other customers. The Natural Gas Act obviously was not enacted in order to enable one subgroup of consumers to benefit at the expense of others in this manner.[2]

2.a. Columbia is fundamentally wrong, as a factual matter, in its repeated references to "delay" by the petitioner pipelines in seeking to recover the Section 110 costs authorized under Order No. 94-A (Br. 6, 7, 20 n.25), and in its related suggestion (*id.* at 8 n.12) that the pipelines were dilatory in not filing their direct billing proposals until some two years after the moratorium

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[2] The amounts at issue have long since been collected by the pipelines from their customers, including respondents. What respondents seek is to recover their payments and impose their share of the costs on the pipelines' other customer or on the pipelines themselves. None of the respondents has ever taken issue with the Commission's conclusion that the direct billing methodology is the most equitable way of allocating these costs among pipeline customers.

on cost recovery was lifted in 1983. In fact, as the respondents are well aware, the Commission and the industry throughout this period were intensively engaged in developing an appropriate, equitable means of permitting the pipelines to pass through to their customers the Section 110 costs at issue here.

First, Order No. 94-A, while lifting the moratorium as of January 1983, specifically permitted first sellers to collect the retroactive production-related costs from the pipelines "over a time period commencing with the date this order becomes effective and ending December 31, 1984." Order No. 94-A, FERC Stats. & Regs., Regs. Preambles (CCH) ("Regs. Preambles") ¶ 30,419 at 30,368 (1983). Consequently, many pipelines were precluded from filing to recover all the relevant costs until late 1984 or early 1985 at the earliest, even when they were promptly billed by their producer-suppliers (which often was not the case). *See* 18 C.F.R. § 154.63(e)(2).

Moreover, in order to minimize the impact of the pass-through of these production-related costs, the pipelines proposed and the Commission ultimately approved an alternative mechanism that would synchronize pipeline obligations to first sellers under Order No. 94-A with first seller refund obligations to the pipelines for essentially the same sales of gas. Specifically, this plan permitted the pipelines to offset their Section 110 costs payable to producers against the amounts the same producers owed the pipelines in refunds—due to overcollections from a separate Commission regulation that the D.C. Circuit had invalidated in 1983 in *Interstate Natural Gas Ass'n, Inc.* v. *FERC*, 716 F.2d 1 (D.C. Cir. 1983), *cert. denied*, 465 U.S. 1108 (1984). On November 20, 1984, the Commission approved this offset mechanism. Order No. 399-A, 49 Fed. Reg. 46,353 (1984). But, on March 5, 1985, a split panel of the D.C. Circuit (over a dissent by then-Judge Scalia) declared it invalid, on the ground that the pipelines' customers should get the refunds due from the producers immediately, without waiting to resolve issues concerning the amounts owed to the producers by the

pipelines. *Interstate Natural Gas Ass'n, Inc.* v. *FERC*, 756 F.2d 166 (D.C. Cir.), *cert. denied*, 474 U.S. 847 (1985).[3]

Thus, it was only shortly after the D.C. Circuit invalidated the offset plan in March 1985—and while the pipelines' challenge to the Commission's Section 110 rules was still pending before the Fifth Circuit[4]—that petitioner Transcontinental Gas Pipe Line Corporation, on May 22, 1985, filed the first of the pipeline direct billing proposals with the Commission. *See* Pet. App. (No. 89-2001) 60a; Columbia App. 1a-25a. The other pipelines filed their respective plans shortly thereafter. There was no "delay" on the part of the pipelines in this case. Moreover, in light of this history, in which all pipelines and their customers were involved, it is astonishing for respondents now to argue that they were unaware of their potential liabilities.

b. Equally inaccurate is Columbia's suggestion (Br. 20, 23) that the recent Commission-driven restructuring of the natural gas pipeline industry postdated the pipelines' direct billing proposals and thus has no connection with this case. In fact, the most critical event that allowed Columbia and its fellow respondents to cut back or discontinue gas purchases from their traditional pipeline suppliers was Commission Order No. 380,[5] issued in June 1984, at the heart of the events in this case. Order No. 380 invalidated longstanding minimum purchase agreements in contracts between interstate pipe-

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[3] Ironically, were it not for that action by the D.C. Circuit, the "retroactivity" that the court condemned in the instant case simply would not have occurred.

[4] It was not until August 19, 1985, that the Fifth Circuit issued its opinion in *Texas Eastern Transmission Corp.* v. *FERC*, 769 F.2d 1053 (1985), *cert. denied*, 476 U.S. 1114 (1986), affirming the Commission's orders requiring retroactive payment of Section 110 costs by the pipelines to producers.

[5] Order No. 380, 49 Fed. Reg. 22,778 (1984), *aff'd sub nom. Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986).

lines and their wholesale customers.[6] It was this dramatic, Commission-imposed seachange in pipeline gas sales markets that made it infeasible for the pipeline petitioners to attempt to recover Section 110 gas costs through the normal PGA process. In 1985, in Order No. 436,[7] the Commission, in effect, dropped the other shoe by mandating that the interstate pipelines become "open-access" transporters. Thus, Columbia's attempt to dissociate this case from the backdrop of industry restructuring must fail.

c. MDG also errs in its assertion (MDG Br. 21-22, 23) that the Fifth Circuit's *Texas Eastern* decision, which approved the retroactive billing of production-related costs by first sellers to their purchasers, did not arise under Section 4 of the Natural Gas Act, as this case does, but rather arose solely under Section 110 of the NGPA. MDG miscontrues this admittedly complex statutory scheme, which involves both the Natural Gas Act and the NGPA working in tandem.[8] As the Commission clearly articulated in the Order No. 94 series, Section 110 applies to *all* of the price categories set out in Title I of the NGPA, including those categories that remain subject to the Commission's Natural Gas Act

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[6] The profound impact of Order No. 380 on pipeline sales is graphically illustrated in Table 3 of Commission Order No. 500-H, Regs. Preambles ¶ 30,867 at 31,520 (1989), *aff'd sub nom. American Gas Ass'n* v. *FERC*, Nos. 87-1588, *et al.* (D.C. Cir. August 24, 1990), which shows that gas sales by the interstate pipelines began to fall off precipitously, and that consequent pipeline exposure to producer claims for "take-or-pay" liability began to increase, immediately after issuance of Order No. 380 in 1984.

[7] Order No. 436, 50 Fed. Reg. 42,408 (1985), *aff'd in part and vacated sub nom. Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988).

[8] Thus, for example, Order No. 94 expressly permitted sellers of NGA-regulated gas "to apply for, and receive, production-related costs in addition to the Natural Gas Act allowances." Regs. Preambles ¶ 30,178 at 31,211 (1980); *see also id.* at 31,213, 31,214 and 31,216. *Accord, Phillips Petroleum Co.*, 12 FERC ¶ 61,080 (1980).

jurisdiction. Thus, the Fifth Circuit's holding in *Texas Eastern*, 769 F.2d at 1066, that the retroactive collection of Section 110 costs "was a fair balancing of the various problems involved" which did not constitute invalid retroactive ratemaking, necessarily *did* encompass, in part, producer sales that remained subject to Section 4 of the Natural Gas Act.[9] Accordingly, contrary to MDG's view, *Texas Eastern* is directly in conflict with the D.C. Circuit's decisions in the instant case.

3. Finally, we note that both Columbia and MDG take an unduly narrow view of the case when they assert (Columbia Br. 22-23; MDG Br. (No. 90-131) 17-18) that the issue presented here is distinct from that in *AGD-II*, *supra*, and therefore that the Court should deny the petition for certiorari here even if it grants the petition in *AGD-II*. In fact, the two cases are plainly related. Both concern the Commission's authority to authorize a surcharge premised upon a customer's purchases during a past period. Both cases arise in the midst of—and directly because of—a massive restructuring in the industry, which would cause grave inequities among different groups of ratepayers if the normal pass-through mechanisms were employed. In both cases, moreover, the D.C. Circuit adopted essentially the same restrictive view of the Commission's ratemaking powers under Section 4 of the Natural Gas Act. The only difference is that in this case the Commission grounded its decision in the waiver provisions of Section 4(d). But

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[9] *Accord, Mobil Exploration and Producing North America, Inc.* v. *FERC*, 881 F.2d 193, 197 (5th Cir. 1989) ("Problems of retroactivity [in cases arising under Section 4] are resolved on the basis of balancing considerations of fairness and the necessities of practical administration.") (citations omitted); *id.* at 198 ("Although the successor's sales made prior to receiving a successor's certificate are in technical violation of the NGA and the filed rate doctrine, FERC can properly exercise its equitable powers to make the successor filing relate back to the time of transfer.") (*citing Plaquemines Oil & Gas Co.* v. *FPC*, 450 F.2d 1334 (D.C. Cir. 1971)).

that is a distinction which, if anything, militates in favor of the Court's granting plenary review in this case, rather than merely holding it in abeyance pending the outcome of *AGD-II*. It certainly does not suggest a basis for denying certiorari here.

CONCLUSION

WHEREFORE, for the foregoing reasons, the Court should grant the petitions for certiorari in No. 89-2001 and in No. 90-131.

Respectfully submitted,

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